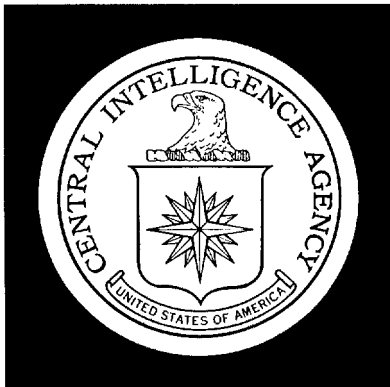


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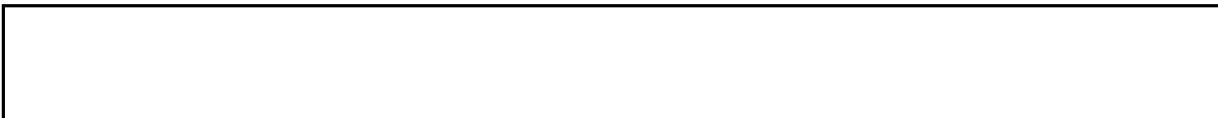
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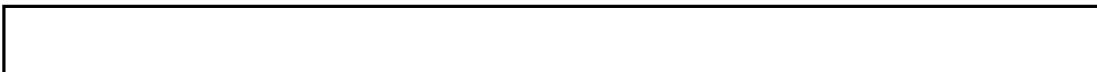
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**[ EGYPT:** There is no overt sign of resistance to President Sadat's bloodless purge.

In his speech to the nation yesterday, Sadat claimed to have foiled a coup attempt by his opponents. He accused Ali Sabri and former minister of interior Sharawi Goma of engineering the plot and said they had sent men to the radio station on Thursday night to prevent him from announcing a referendum on reforming the Arab Socialist Union (ASU). There is no other information to confirm Sadat's charges.

A major theme of the speech derived from Sadat's pledge to launch a new era by democratizing Egypt's political institutions. Previous indications that Sadat intended to dismantle the ASU were strengthened by his remarks that "sooner or later" the party would be dissolved and a new body elected. He vowed that free elections would be held from "top to bottom" under his personal supervision.

Following Sadat's address to the nation yesterday, the formation of a new cabinet was announced. Many of the key figures in the previous government were retained, including Prime Minister Fawzi and Foreign Minister Riad. Most of the ousted ministers were replaced with men who at first glance appear to have been chosen for their technical and professional qualifications.

Sadat appears to be laying the groundwork for the harassment and even the prosecution of at least some of the deposed officials, particularly former minister of interior Goma.

Sadat's instructions to the Minister of Justice to "investigate some elements...working against the interest of the masses" and his well-publicized decision to curb internal security practices are clearly designed to exploit popular grievances against Goma, who as Egypt's chief security officer had drawn criticism from various segments of the

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populace, but particularly the country's youth. Sadat's moves have, in fact, received broad popular support, according to press reports from Cairo. The purge continued yesterday with the National Assembly withdrawing the memberships of 17 of their number and electing Social Affairs Minister Hofiz Badawi as the new speaker.

The Soviets probably have been taken aback by Sadat's bold move, and undoubtedly are now assessing the significance of the dismissals for their own position in Egypt. For the short term, Moscow is likely to allow the dust to settle somewhat and maintain a low profile, the same approach followed after Nasir's sudden death last year. But should Sadat's moves appear at some point to endanger or diminish the Soviet position in Egypt, Moscow would be likely to feel compelled to take a more active hand in internal Egyptian affairs.

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USSR: Soviet party leader Brezhnev's proposal Friday to "start negotiations" on Mutual Balanced Force Reductions (MBFR) probably was keyed to the June NATO ministerial meeting in Lisbon.

The Soviets are aware that the US and some of its allies have cited Moscow's reluctance to engage in substantive discussions on MBFR as a reason to move cautiously in responding to Moscow's pet project for a Conference on European Security (CES). Brezhnev's latest remarks appear aimed at shifting the burden of the dialogue to NATO.

Speaking in Tbilisi, Brezhnev said the Soviets are ready to "make clear" their position on MBFR, but said that the West must first decide to enter negotiations. The Soviet position on MBFR, as stated by Brezhnev in his speech to the 24th party congress in March, is that Moscow favors the reduction of "armed forces and armaments" in areas of dangerous confrontation, particularly in central Europe. His latest remarks add nothing to the substance of that position, and Soviet diplomats have said recently that it is incumbent on the Western sponsors of MBFR to frame a detailed proposal.

Nevertheless, it is not clear from Brezhnev's remarks when or in what forum the Soviets would propose to conduct talks on MBFR. In the past the Soviets have said that MBFR could be discussed in a body to be established by a CES or, alternatively, in any other forum acceptable to all interested parties.

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NORTH VIETNAM: Hanoi's latest move on the prisoner-of-war issue does not presage any breakthroughs.

The North Vietnamese gambit, contained in a statement Thursday by Hanoi's news agency, is a reply to a South Vietnamese offer last month to release 1,770 North Vietnamese prisoners. Saigon has announced that of the 1,770, 570 were sick and wounded men who could be released directly to North Vietnam; the other 1,200 were able-bodied prisoners who had been held four years or more, and the South Vietnamese proposed that they be interned in a neutral country.

The North Vietnamese reply takes the standard Communist line that the prisoners are "patriots illegally arrested and detained by the US and its puppets," and it recalls Communist offers made last December to receive any of the "patriots" who want to go North. No reference is made to the internment aspect of Saigon's offer. Hanoi's reply then lays down conditions for a prisoner turnover that are more specific than the Communists have previously proposed in advance but are not much more stringent than those under which past transfers have actually taken place.

This announcement seems designed mainly to take some of the steam out of recent allied initiatives on the prisoner issue. Many North Vietnamese prisoners held in South Vietnam in fact, remain subject to the discipline of the Communist apparatus, through which they may be enjoined to refuse repatriation.

Because Saigon apparently will have trouble producing 570 sick and wounded willing to be repatriated, Hanoi probably thinks it may be able to brand the South Vietnamese offer as a propaganda ploy.

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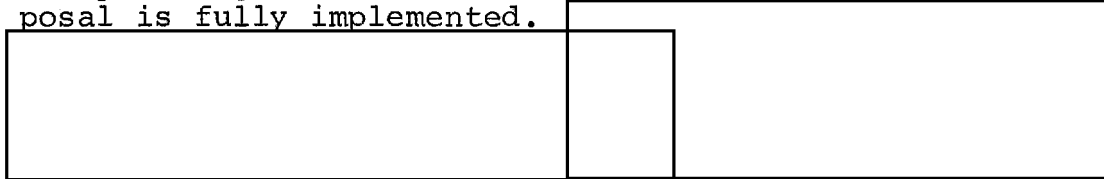
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In any event, the North Vietnamese statement is concerned solely with Vietnamese prisoners. There is no implication of a change in Communist policy on US prisoners held in North Vietnam, and it is highly unlikely that Hanoi would release Americans as a reciprocal gesture even if the South Vietnamese proposal is fully implemented.



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JAPAN-CHINA: Tokyo is considering relaxation of restrictions on trade with China.

According to a member of Prime Minister Sato's faction within the ruling party, high-level consideration is being given to facilitating Japanese Export-Import Bank loans to finance trade with Communist China. The tactic under consideration involves revising the Export-Import Bank law so that government approval will not be required for such loans. In recent years, approval has never been granted, and the government has sought to dodge this sensitive issue.

In a similar vein, Trade Minister Miyazawa on 11 May told the Diet that the so-called "Yoshida letter," in which Tokyo in 1964 informally agreed to avoid trade in strategic items and refrain from extending government approved credits to Peking, is no longer valid. He claimed it was only effective for the 1964 fiscal year.

Trade ministry officials denied publicly that this represented a change in policy, but Prime Minister Sato and his colleagues on the right wing of the ruling conservative party clearly are under heavy pressure from big business, public opinion, and the party's left wing to allow Export-Import Bank financing of exports to China. The formula under consideration is probably viewed by Sato as a practical way to satisfy these pressures without directly repudiating the Yoshida letter or compromising basic support of Taipei.

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HUNGARY-US: The Hungarian Government has said it is willing "to enter a new positive phase" in relations with the US.

Hungarian Foreign Minister Peter met with Ambassador Puhan for an hour on Thursday and repeatedly stressed the Hungarians' desire for improved ties. Peter expressed his regrets that Hungarian statements on international issues, presumably including his own ill-conceived speech to the UN last fall, have given a negative impression. He promised that his government would reciprocate for the lifting by the US of restrictions on information activities, although he did not say when. Peter also conveyed party leader Kadar's regrets that he had not received Ambassador Puhan up to now and said that Kadar would meet with him after the Ambassador's return from the US.

Peter's forthcoming remarks may have been timed to influence the Ambassador's consultations in Washington. The groundwork for the changed attitude was in effect laid last March during Kadar's surprisingly moderate comments on US ties in a press interview. Until Peter's presentation, however, there had been little indication that the Hungarians were preparing to follow through on Kadar's pronouncement.

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FRANCE: Seeking to apply the brakes harder to retard domestic inflation, the Bank of France has raised its discount rate by one quarter percent, to 6.75 percent.

Inflation is emerging as a primary concern. Consumer prices are climbing at an annual rate of five to six percent and the cost of nearly a third of French imports are up slightly as a result of the higher exchange costs of the Deutschemark, guilder, and Swiss franc. The use of only a small increase in the discount rate reflects concern that the restrictive policy should not excessively dampen the upswing in consumer outlays, presently the most dynamic element in French economic growth.

Although higher interest rates will tend to attract foreign funds and thus expand the credit base, inflows can be limited by France's strict exchange control system. Demonstrating France's ability to implement domestic monetary policies free from external influence, the monetary authorities used the discount rate as a restrictive measure against inflation.

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INDIA: Prime Minister Gandhi should have little trouble gaining parliamentary approval for her decision to nationalize general insurance companies, thus completing the government's take-over of the insurance business.

Over 100 firms, including 42 foreign firms, with \$320 million in assets will be affected by the new move. Included are four US firms earning about \$130,000 annually on premium income of about \$1.3 million. New Delhi has agreed to compensate the firms, but determination of the fair value may cause problems.

Nationalization of general insurance will be of little economic benefit to the country and, in fact, will tend to dampen private foreign investor interest. Nevertheless, the measure will probably be well received as was domestic bank nationalization in 1969. The take-over represents one of a number of measures that Mrs. Gandhi could have taken to fulfill campaign promises to bring "progressive government" to the people.

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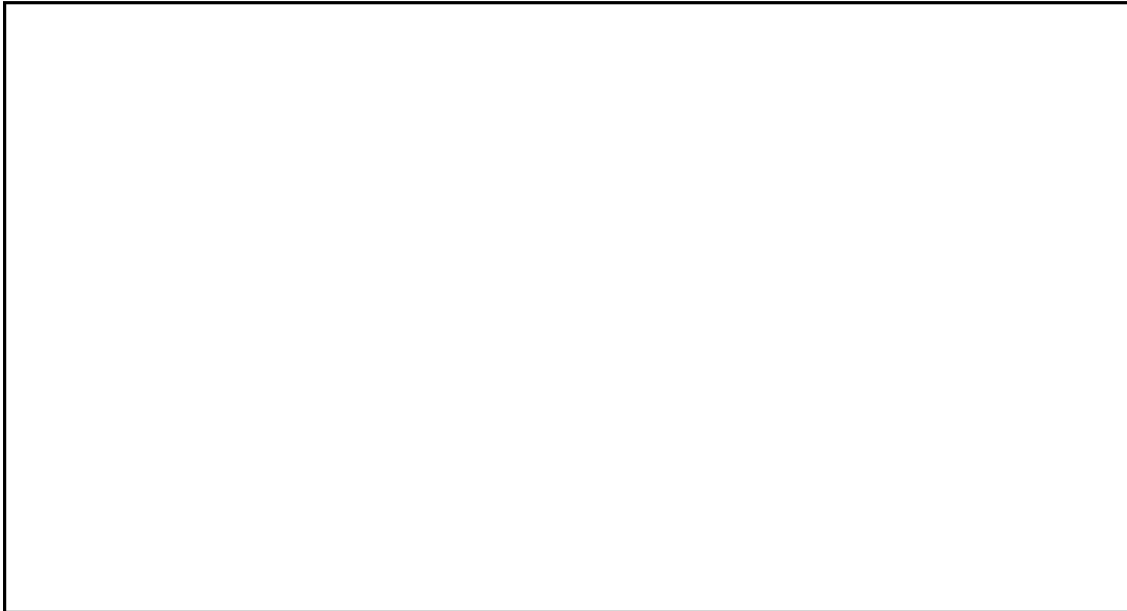
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COMMUNIST CHINA - IRAN: Communist China and Iran will announce the establishment of diplomatic relations during the first week of June [redacted]

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[redacted] Iran's primary motivation for recognizing Communist China is its fear of being left behind in the trade and political advantages it expects will accrue to those nations getting on the recognition bandwagon. Although representations by Taipei might cause some delay, in the end Iran will probably agree to a recognition formula acceptable to Peking and not Taipei. Iran's quick conclusion of negotiations with the Peking regime may parallel similar prompt action by Turkey, and impel other countries now considering diplomatic ties with Peking to begin talks soon.

[redacted]

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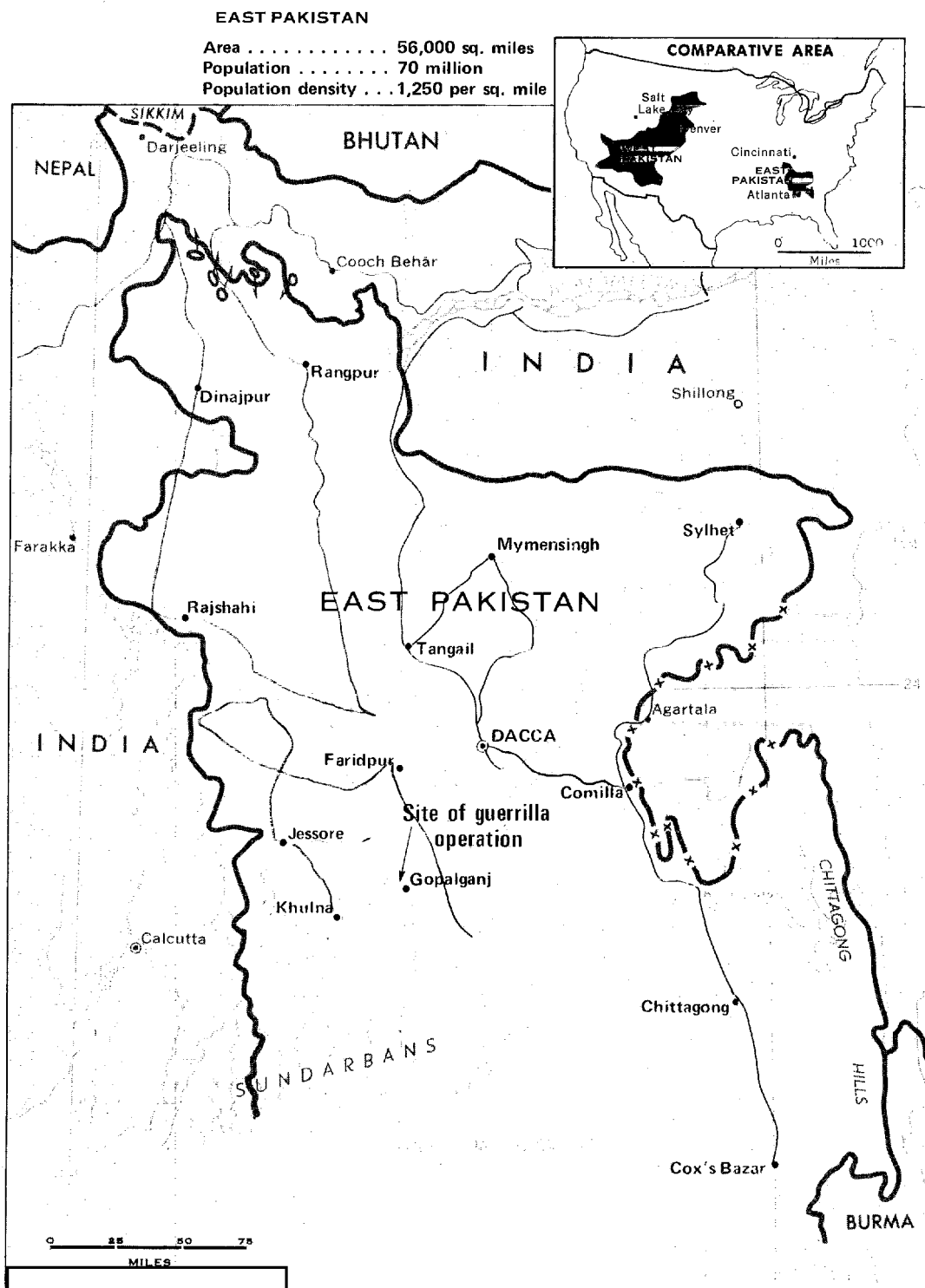
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PAKISTAN: On 11 and 12 May, Bengali nationalists in the area near Gopalganj used small boats to capture eight river barges, about \$400,000 worth of jute, and a steamer with 300 passengers. Transportation officials have now decided not to use this route--the only one open between Khulna and Dacca during the rainy season--until it is secured by the army. The guerrilla operation was the most successful and by far the most significant the Bengalis have carried out. Most of their military effort so far had gone into futile attempts to hold territory against the greatly superior regular army.

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EAST GERMANY: Erich Honecker yesterday made the first significant personnel change in the government since he assumed power. He named politburo member and economics expert Horst Sindermann as first deputy to Premier Willi Stoph, replacing Alfred Neumann, also a politburo member. Sindermann is party first secretary of the industrially important Halle district and brings considerable economic skill to his new post. Presumably Neumann retains his politburo membership. The move probably stems in part from Honecker's desire to demonstrate his authority and partly from his commitment to the new five-year economic plan, which is characterized by rationality and gradual growth, rather than the unrealistic "forced-draft" plans that had been supported by Ulbricht.

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NATO: The Eurogroup members to date have been able to subscribe only \$388 million of the \$420 million they pledged last December to the infrastructure portion of the European Defense Improvement Program (EDIP), but concern over possible US force reductions will increase pressures on them to make up the difference. Failure of the Belgians to plan sufficient funds in their current defense budget accounts for most of the shortfall. It appears that the West Germans, who are already directly or indirectly financing most of the EDIP, may have to pick up the Belgian shortfall if they want to ensure full subscription by the time the NATO defense ministers meet later this month in Brussels. The current status of the Eurogroup effort will be reviewed by NATO on 17 May.

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NETHERLANDS: The lower house's failure on Wednesday to select a government formateur fore-shadows a lengthy period of post-election negotiations to form a new government. The governing four-party coalition of the three confessional parties and the Liberal Party is at present bargaining with a right-wing socialist party--the Democratic Socialists '70--but the latter's program of strict governmental austerity is anathema to the prolabor wings of the confessional parties. In this situation the Queen will now nominate someone to take soundings among the parties in an attempt to reconcile the differences among them. Many observers expect Professor Steenkamp, the intellectual mentor of the Catholic party, to be given this task, but anticipate also that he will be only the first in a series.

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AFRICA: President Kaunda of Zambia, chairman of the Organization of African Unity (OAU) for this year, has announced that the heads of state meeting will convene on 21 June in Addis Ababa rather than in Kampala, Uganda, as originally planned. It is not clear how many governments actually responded to Kaunda's earlier proposal to move the summit to Addis Ababa. The Zambians have announced that a majority of those who replied were in favor, however, thus enabling Kaunda to claim an end to the debate on the location that has been dragging on since February.

President Amin of Uganda has not yet reacted publicly, but he might be willing to accept the move in return for uncontested admission to the conference, although he presently has no such guarantee. Seating the Amin government remains a highly controversial issue that could provoke sufficient dissension at the preliminary foreign ministers meeting in mid-June to threaten a postponement of the eighth annual OAU session.

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